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Setting the Scope of and the Limits to the Incremental Approach to Sovereign Debt Restructurings

RÉGIS BISMUTH — 25 January, 2017

Anyone interested in legal issues surrounding sovereign debt should pay careful attention to the last special edition of the Yale Journal of International Law in which a framework is set forth to ensure the progressive development of orderly sovereign debt restructurings (SDRs). This prospective agenda relies upon a principles-based approach to SDR that revolves around various soft-law instruments, such as UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing, as well as its Roadmap and Guide on Sovereign Debt Workouts, the UN General Assembly resolution 63/319 on Basic Principles on Sovereign Debt Restructuring Processes and the UN Human Rights Council Guiding Principles on Foreign Debt and Human Rights.

While I must admit that I was initially sceptical about the relevance and the utility of those (sometimes overlapping) instruments, the proposed incremental approach to SDRs crafted by Bohoslavsky and Goldmann is particularly convincing. It undoubtedly constitutes to date the best alternative to an unfeasible legally binding statutory framework to sovereign bankruptcy and an appropriate complement to the still insufficient contractual approaches with new model Collective Actions Clauses (CACs).

"Incremental" in the sense that it seeks a progressive development of the law and to influence decision makers in the long-run, the suggested approach also aims to be holistic in its scope. Its underlying objectives are both to overcome the persistency of a so-called "private law paradigm" , which doesn't take into account public interest objectives (such as debt sustainability) in sovereign debt disputes, as well to better consolidate these nascent international regimes and to better coordinate them with other fields of international (or transnational) law. Within this framework, in my view, this ambitious project prompts three questions about its limits and its scope that were not specifically dealt with in this symposium: (1) uncovered areas deserving to be integrated into the project, (2) the necessity to tailor the implementation of SDR imperatives and (3) their – sometimes questionable – influence on rules of sovereign immunity.

Uncovered areas

The various soft law instruments dealing with SDRs that have been adopted these past few years already encompass a large number of topics. However, some may wonder whether more could be done to ensure a greater comprehensiveness of the discipline. For instance, Daniel D Bradlow's article highlights the insufficient integration of business and human rights standards into SDRs and identifies gaps regarding the identification of the human rights responsibilities of creditors.

To some extent, the same could be said of international financial standards devised under the auspices of the Financial Stability Board (FSB), notably those adopted by the Basel Committee or the International Organization of Securities Commission (IOSCO). For instance, the decisions taken by credit rating agencies have proven to significantly influence sovereign debt markets and to have precipitated the Greek debt crisis (see for instance here and here). However, the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies does not incorporate any specific discipline related to sovereign debt and, for example, the circumstances in which rating agencies should refrain from acting in ways that could generate sovereign insolvencies or compromise SDRs. Only the EU has so far adopted limited rules addressing the specificities of unsolicited sovereign ratings through Regulation 462/2013 (see also my analysis here). One can also query whether there is some inconsistency between the UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing, for which "a lender is responsible to make a realistic assessment of the sovereign borrower's capacity to service a loan" (Principle 4), and the Basel Committee prudential standards, which almost treat sovereign debt as being roughly equivalent to risk free and even encourage financial institutions to hold such assets (see here). It thus seems necessary to ensure better linkages between international financial regulation and the promotion of the SDR agenda.

Tailoring the implementation of the SDR agenda

Another important issue to be discussed concerns the way in which the SDR agenda is taken into consideration within the framework of the development of new domestic or international instruments. For instance, the few existing pieces of anti-vulture legislation are not of the same scope and are not necessarily applicable to all restructuring processes. This is the case of the UK Debt Relief Act of 2010 that only applies to 36 States participating in the IMF/World Bank Heavily Indebted Poor Countries initiative (HIPC). With Greece and Argentina not being eligible for the HIPC initiative, the two largest SDRs in history would have not benefited from the protection offered by this legislation. While it is understandable that the adoption of such a legislation was subject to significant political constraints, it is important to note that it only partially takes into account the imperatives for orderly SDRs.

An example of tailored implementation of the SDR agenda is to be found in some of the latest international investment agreements and, more specifically, in the EU-Canada Comprehensive Economic and Trade Agreement (CETA). Instead of entirely excluding sovereign debt from the definition of covered investments (such as in the model India BIT (article 1.7) or the model Colombia BIT (article 2.1)), the specificity of CETA lies in the choice to exclude only the admissibility of investment arbitration claims when it involves "a restructuring of debt of a party" (See Annex 8-B of CETA).

Interestingly, the text of CETA shows that both parties have adequately drawn the lessons from the unfortunate experiences of both the Greek and Argentinean SDRs, so as to prevent holdout litigation through investment claims disrupting sovereign restructurings. Annex 8-B indeed provides that a "negotiated restructuring" is defined as "(a) a modification or amendment of debt instruments, as provided for under their terms" (e.g. through CACs), "including their governing law" (e.g. through retroactive CACs like in the

Greek case) or "(b) a debt exchange or other similar process in which the holders of no less than 75 per cent of the aggregate principal amount of the outstanding debt subject to restructuring have consented to such debt exchange or other process" (e.g. in the absence of CACs like in the Argentinean case). Annex 8-B nonetheless provides that claims based on SDRs are admissible in case of violation of national treatment or most favoured nation treatment, thereby implementing the principle of equitable treatment that "imposes on States the duty to refrain from arbitrarily discriminating among creditors" (UNGA Basic Principles on Sovereign Debt Restructuring Processes, Principle 5).

Adverse effects on sovereign immunity

The UK anti-vulture funds legislation is an example of an incomplete but still useful implementation of SDR agenda in domestic law while CETA provides an example of a tailored implementation in an international agreement. It should nonetheless be noted that taking into account SDR imperatives also requires a careful analysis and, more particularly, an assessment as to whether such an approach does not more generally affect the legal framework applicable to situations that have no nexus with sovereign insolvency. In that respect, the issue of sovereign immunity is particularly telling. Immunity from execution is an efficient tool to block holdout litigation. In that respect, the UNGA Basic Principles provide that "sovereign immunity from jurisdiction and execution regarding sovereign debt restructurings is a right of States before foreign domestic courts and exceptions should be restrictively interpreted" (Principle 9). Likewise, The UNCTAD Roadmap includes several similar references (see pp. 5, 58, 59).

When assessing the legality of enforcement measures sought by holdout creditors in the past years, some domestic courts have interpreted very restrictively customary rules of sovereign immunity so as to prevent the seizure of state property. It was for instance the case in France and Belgium where supreme courts considered that the way in which the waiver of immunity of execution included in Argentinean bonds was drafted did not allow for the seizure of assets (see here my analysis of NML v. Argentina before French courts). Without going into the technical details, it is worth pointing out that domestic courts did not take into consideration the existence of holdout creditors. They have rather developed new restrictive standards governing foreign sovereign immunity applicable to all enforcement measures, including those related to other types of liabilities such as arbitral awards, damages for torts or compensation to be paid to embassy employees.

Holdout litigation has played a significant role in the evolution of the rules of sovereign immunity – recalling in some jurisdictions the doctrine of absolute immunity prevalent a century ago – even when they are applied in cases not involving sovereign debt. The suggested incremental approach to SDRs should therefore duly take into consideration the adverse effects that it might more broadly have on general international law.

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